MITCHELL | HAMLINE School of Law

William Mitchell Law Review

Volume 8 | Issue 2 Article 11

1982

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DUE PROCESS REQUIREMENTS OF INTERIM RATES AND COST ADJUSTMENT CLAUSES

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I. INTRODUCTION

The law's delay was one of the considerations that prompted Hamlet to ponder the ultimate question of whether "[t]o be or not to be."[1] The solicitors of *Jarndyce and Jarndyce*,[2] on the other hand, took a more sanguine view and parlayed it into long and lucrative careers spanning several generations. With an attitude somewhere between the brooding contemplation of Hamlet and the benign acceptance of the *Jarndyce* solicitors, modern day utility regulators, managers, and customers continue to wrestle with the law's delay in the form of regulatory lag.

A great number of proposals have been advanced in an attempt to mitigate the adverse effects of regulatory lag. Two of these have, to varying degrees, received general acceptance in the regu-

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1. W. SHAKESPEARE, HAMLET act III, scene i, line 55.
2. C. DICKENS, BLEAK HOUSE, ch. 1 (London 1887).

latory community. The first is interim rates, a method whereby the utility is either authorized to implement higher rates, or compelled to implement lower rates, pending final determination of permanent rates by the jurisdictional regulatory body.[3] The second proposal, widely accepted in a restricted form, is the cost adjustment clause. Such a clause allows a utility to either increase or decrease its rates in accordance with fluctuations in current operating costs specified in the clause. The intent of these proposals is to both reduce the lag common to modern rate cases and to mitigate the revenue loss to the utility during the lag period. It is ironic that interim rates, which mitigate only revenue loss during the lag period and consequently increase the period of lag by reducing the incentive for expediting rate proceedings, have received general acceptance in the regulatory community, while the adjustment clause, which can reduce both the lag period and the revenue loss attendant thereon, has received only a grudging acceptance and has historically been restricted primarily to the recovery of fuel costs.[4]

While the need to reduce regulatory lag is primarily a financial one, the legal problems to which it gives rise are rooted in the constitutional principles governing due process and the taking of private property for public use. This article traces the development of the application of those principles, first to the public utility concept in general, and second, to the specific issues of interim rates and cost adjustment clauses. Special emphasis is placed upon public utility regulation in Minnesota and the relative merits of interim rates and adjustment clauses as utilized in Minnesota.

II. THE PUBLIC UTILITY CONCEPT

Although modern regulatory bodies look almost exclusively to the statutes of their respective jurisdictions to determine the scope of their authority, the public utility concept was born in the English common law several centuries before the technological development of the industries typically governed by modern public utilities statutes.[5] Notwithstanding these tremendous technological

3. "Permanent rates" is a term of art meaning rates approved by the appropriate regulatory body upon conclusion of hearings on a utility's request for increased rates. In times of persistent inflation the phrase is not synonymous with longevity.

4. *See infra* note 88.

5. The Minnesota Public Utilities Act, effective January 1, 1975, restricts the legal definition of a public utility to certain retail sellers of natural, manufactured, and mixed gas and electric service. MINN. STAT. § 216.02 (1982). Telephone companies are not le-

differences, the modern statutes have been expressly upheld on the basis of common law principles.

In 1876, the year Alexander Graham Bell invented the telephone and six years before the first electric generating station was put into commercial operation in this country,[6] the United States Supreme Court decided five companion cases, known as the *Granger* cases.[7] These cases upheld a series of state statutes establishing maximum rates for the storage and carriage of agricultural commodities and passengers by privately owned grain elevators, warehouses, and railroads. In the most famous of these cases, *Munn v. Illinois*,[8] the Court upheld the conviction of the owners of a grain elevator located on the Chicago harbor for failing to comply with an Illinois statute establishing maximum storage rates for grain. The owners appealed the conviction on the ground that the statute constituted an unconstitutional exercise of power by the state, including the taking of private property for a public use without just compensation. The Court held the statute constitutional and stated, "It [the statute] established no new principle in the law, but only gives a new effect to an old one."[9] The old principles the Court found to be given new effect by the statute were those discussed by Lord Chief Justice Hale of the King's Bench of England approximately two hundred years earlier in his legal treatise *De Portibus Maris*.[10] The Court cited with approval the following principle from Lord Hale's essay:

> If the king or subject have a public wharf, unto which all persons that come to that port must come and unlade or lade their goods as for the purpose, because they are the wharfs only licensed by the king, . . . or because there is no other wharf in that port, as it may fall out when the port is newly erected; in

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gally defined as public utilities but have been regulated on a statewide basis since 1915. 1915 Minn. Gen. Laws ch. 152 (current version at MINN. STAT. ch. 237 (1982).

6. The Pearl Street Station in New York City was put into commercial operation on September 4, 1882, with 59 customers. E. VENNARD, THE ELECTRIC POWER BUSINESS (1962).

7. The Grange, or Patrons of Husbandry, was a national agricultural society at one time headquartered in Minnesota. During the last half of the 19th century it successfully lobbied legislatures in a number of states to adopt statutes regulating charges for the storage and carriage of agriculturally related products. Such legislation was referred to as "Granger legislation" and the cases litigating the validity of such legislation became known as the "*Granger* cases."

8. 94 U.S. 113 (1876).

9. *Id.* at 134.

10. Hale, *DePortibus Maris*, in A COLLECTION OF TRACTS RELATIVE TO THE LAW OF ENGLAND 45, 78 (F. Hargrave 1787).

> that case there cannot be taken arbitrary and excessive duties for cranage, wharfage, pesage, etc., neither can they be enhanced to an immoderate rate; but the duties must be reasonable and moderate, though settled by the king's license or charter. For now the wharf and crane and other conveniences are affected with a public interest and they cease to be *juris privati* only.[11]

The Court found that the appellants' elevator, together with other elevators on the Chicago harbor, held a "virtual monopoly" on the grain trade passing between the western grain producing states and the more populous eastern seaboard. Under these conditions, "Their business most certainly tends to a common charge, and is become a thing of public interest and use."[12]

Munn was presumably selected as the case in which to discuss the principles of public regulation because the similarity between the grain elevators on the Chicago harbor and the wharves on the English harbors discussed by Chief Justice Hale made the application of existing regulatory principles appear a logical extension of the common law. In the remaining four cases, the Court applied those same principles with little further discussion and upheld state statutes establishing maximum rates for transportation of freight and passengers by privately owned railroads.[13] Thus, for the first time the Court expressly discussed and allowed the application of the public utility concept that privately owned enterprises, particularly those which tend to a monopoly and to which members of the public must come for service, are subject to public regulation.[14]

III. Reasonable Rates Versus Confiscatory Rates

The Court's concern with reasonable rates in the *Granger* cases focused on the need to protect customers of regulated industries from excessive rates and not the right of those industries to earn a reasonable return on their capital. This is clear from the language of Chief Justice Hale to the effect that the duties taken by an own-

11. 94 U.S. at 127.

12. *Id.* at 131-32.

13. The other *Granger* cases and the states in which they originated are Chicago, B. & Q.R.R. v. Iowa, 94 U.S. 155 (1876) (Iowa); Winona & St. P.R.R. v. Blake, 94 U.S. 180 (1876) (Minnesota); Peik v. Chicago & N.W. Ry., 94 U.S. 164 (1876) (Wisconsin); and Stone v. Wisconsin, 94 U.S. 181 (1876) (Wisconsin).

14. For a thorough analysis of the origins of this concept see McAllister, *Lord Hale and Business Affected with a Public Interest*, 43 Harv. L. Rev. 759 (1936).

er of a wharf affected with a public interest must not be "arbitrary and excessive," but must be "reasonable and moderate."[15] While the Court made passing reference in *Munn* to the idea that the power of the state to prescribe maximum rates might have constitutional limitations, and that it was a power which might be subject to abuse, it stated that for protection against abuses of the legislature the people must resort to the polls and not to the courts.[16]

In *Peik v. Chicago & North-western Railway*,[17] the Court rejected the argument that courts must ultimately decide what are reasonable rates and held that rates fixed by the legislature are binding upon the courts. It once again stated that the only appeal was to the legislature. Thus was the power of the state to prescribe maximum rates established without the concommitant obligation of the state to ensure a reasonable return to the regulated industries, and without providing a judicial remedy for any potential violation of this power by the state. Ten years later, however, in upholding a Mississippi statute creating a railroad commission empowered to established maximum rail rates, the Court recognized by way of dictum that the power to regulate is not the power to destroy. A state cannot, under the pretense of regulation, do that which "amounts to a taking of private property for public use without just compensation, or without due process of law."[18] The Mississippi commission, however, had not yet established any rates and the Court was not directly confronted with this constitutional issue.

In *Chicago, Milwaukee & St. Paul Railway v. Minnesota*,[19] a challenge to legislation creating the Minnesota Railroad and Warehouse Commission, the Court addressed the taking issue. The Minnesota commission had established maximum rates for the carriage of milk between points in Minnesota. The Minnesota Supreme Court had ruled that these rates were not subject to judicial review for reasonableness.[20] The United States Supreme

15. 94 U.S. at 127.

16. *Id.* at 134.

17. 94 U.S. 164, 178 (1876).

18. Stone v. Farmers Loan & Trust Co., 116 U.S. 307, 331 (1886). This is one of three companion cases reported as the *Railroad Commission Cases*. The others are Stone v. Illinois Central R.R., 116 U.S. 347 (1886), and Stone v. New Orleans & N.E. R.R., 116 U.S. 352 (1886).

19. 134 U.S. 418 (1890).

20. *See* State *ex rel.* Railroad & Warehouse Comm'n v. Chicago, M. & St. P. Ry., 38 Minn. 281, 37 N.W. 782 (1888).

Court held that under such an interpretation, which it was bound to accept, the law denied the railroad due process of law by depriving it of the right to a judicial investigation into the reasonableness of rates.[21] The Court ordered dismissal of the mandamus action brought in the state court to compel the rates established by the commission.[22] Thus, without expressly so stating, the Court reversed in part its holdings in the *Granger* cases and created a judicial remedy for confiscatory rates established by state laws or regulatory bodies.

It was soon clearly established that the federal courts had jurisdiction to enjoin the enforcement of confiscatory rates.[23] Federal jurisdiction over local rates was strongly resisted by the states, however, particularly those wherein Granger legislation had been adopted.[24] Congress subsequently removed federal jurisdiction over state ratemaking orders in those cases in which a remedy is readily available in the state courts.[25] Federal courts retain jurisdiction over suits challenging the validity of state regulatory statutes in general.[26]

IV. CONFISCATORY NATURE OF REGULATORY LAG

Regulatory lag is that period of time between the filing of a rate case, wherein the utility alleges a revenue deficiency, and the time when the regulatory commission provides remedial relief in the form of an order authorizing higher rates.[27] Orders of regulatory bodies establishing rates have long been held to be legislative in nature. They prescribe new rules for future application, as opposed to adjudicating rights and liabilities under existing or past facts and laws.[28] Such orders have the same force and effect as

21. 134 U.S. at 456-57.

22. *Id.* at 458-59.

23. *See* Smyth v. Ames, 169 U.S. 467, 526 (1898).

24. *See Ex parte* Young, 209 U.S. 123 (1908) (Attorney General of Minnesota incarcerated for contempt of federal court order enjoining enforcement of rail rates established by state's Railroad and Warehouse Commission).

25. *See* 28 U.S.C. § 1342(4) (1976).

26. *See* Minnesota Gas Co. v. Public Serv. Comm'n, 523 F.2d 581 (8th Cir. 1975), *cert. denied*, 424 U.S. 915 (1976) (upholding Minnesota Public Utilities Act).

27. This is the most common scenario in present inflationary times. In the less frequent cases in which the regulatory body orders a rate reduction, regulatory lag adversely affects the consumers. This has happened at least once in Minnesota since the adoption of the Public Utilities Act. *See* Minnesota Power & Light Co., Docket No. E-015/GR-76-408 (Minn. P.S.C., Dec. 18, 1976).

28. *See* Prentis v. Atlantic Coast Line Co., 211 U.S. 210, 226 (1908).

legislative enactments and are subject to the same restrictions,[29] including the prohibition against retroactive application.[30]

In addition to canons of statutory interpretation disfavoring retroactive application of legislative enactments, there are also sound practical reasons for restricting ratemaking orders to prospective application. The Michigan Supreme Court stated such a reason in a decision reversing the retroactive application of an order of that state's commission reducing telephone rates which it had previously approved. The court said, "For the state to prescribe utility rates, forbid the utility to charge any other rates, and then say that those rates may be declared unjust and unreasonable as applied to executed transactions shocks the conscience. Under such a rule how could the utility order its affairs?"[31]

This same reasoning seems equally valid in the more common instances in which a commission authorizes increased rates. Utility consumers are also in need of finality in executed transactions for purposes of ordering their affairs. The prohibition against retroactive application is well established in both state and federal jurisdictions.[32] Thus, in the absence of other remedial provisions, revenues lost to the utility or its consumers during the period of lag are permanently lost, with no opportunity for future recoupment.

V. INTERIM RATES

The most direct method of preventing revenue loss to either the utility or its customers during the period of regulatory lag is through interim relief, in the form of either higher or lower rates, pending determination of appropriate permanent rates. The question then arises as to what are, or should be, the guidelines in fixing interim rates?

In 1923, the United States Supreme Court upheld a provisional rate increase authorized by the Interstate Commerce Commission even though the increase was based upon evidence insufficient to

29. *See* State v. Tri-State Tel. & Tel. Co., 204 Minn. 516, 284 N.W. 294 (1939).

30. *See* Claridge Apartments Co. v. Commissioner of Internal Revenue, 323 U.S. 141, 164 (1944) ("Retroactivity, even where permissible, is not favored, except upon the clearest mandate.").

31. Michigan Bell Tel. Co. v. Public Serv. Comm'n, 315 Mich. 533, 538-39, 24 N.W.2d 200, 206 (1946) (quoting appellee's brief).

32. *See* Natural Gas Pipeline Co. v. Federal Energy Regulatory Comm'n, 590 F.2d 664 (7th Cir. 1979); State *ex rel.* Utilities Comm'n v. Farmers Chem. Ass'n, 42 N.C. App. 606, 257 S.E.2d 439 (1979); *cf.* Texas Water Rights Comm'n v. City of Dallas, 591 S.W.2d 609 (Tex. Civ. App. 1979) (commission has power to make rates retroactive to any date after which it assumes jurisdiction).

enable the commission to dispose of the issue completely and permanently.[33] After finding that the commission had provided the parties with the opportunity for a full hearing, the Court held that the requirements of due process were not violated merely by the provisional nature of the order nor because further investigation might require a revision of the provisional rates.[34]

While courts generally require a less stringent test for interim rates than for permanent rates, interim rates are not immune from the constitutional prohibition against confiscation. In *Northwestern Bell Telephone Co. v. Hilton*,[35] two telephone companies requested permission from the Minnesota Railroad and Warehouse Commission to implement increased interim rates pending the outcome of the commission's ongoing investigation of existing rates. The commission denied the request for interim relief and the telephone companies sued in federal court to enjoin enforcement of the order. From the substantial evidence received by the commission in its investigation, the court found the existing rates confiscatory, as the telephone companies had alleged. The court enjoined enforcement of the commission order denying interim relief and entered its own order authorizing such relief. It did not, however, automatically accept the interim rate levels proposed by the telephone companies, but adopted rates that a dissenting member of the Minnesota commission had thought authorized by the evidence received.[36] In commenting upon the nature of temporary rates, the court quoted approvingly from *Love v. Atchison, T. & S.F. Railway*,[37] decided by the Eighth Circuit Court of Appeals ten years earlier. "It is as much a violation of the Fourteenth Amendment to take the property of the railroad company without just compensation during the process of ratemaking as it is after the completion of that process."[38] Two years later, the United States Supreme Court also cited *Love* in upholding a lower court order enjoining the enforcement of confiscatory interim telephone rates established by the New York commission.[39]

Because the right to be free from confiscatory rates is founded on constitutional principles, it follows that regulatory bodies have

33. New England Div. Case, 261 U.S. 184 (1923).
34. *Id.* at 195-96.
35. 274 F. 384 (D. Minn. 1921).
36. *Id.* at 395.
37. 185 F. 321 (8th Cir. 1911).
38. 274 F. at 393.
39. Prendergast v. New York Co., 262 U.S. 43, 49-50 (1923).

not only the authority but the obligation to authorize adequate interim rates, even in the absence of statutory provisions expressly granting such authority.[40] The New Mexico commission has granted interim relief when it believed such relief warranted by the circumstances, despite the absence of either express statutory authority or a request for such relief by the subject utility.[41] This procedure was subsequently cited with approval by the state's supreme court.[42]

The crucial test in many jurisdictions as to whether or not interim relief should be granted is not the presence or absence of statutory provisions, but whether or not the circumstances warrant such relief on a case by case basis. The nature of the evidence required to establish a justification for such relief, however, varies from jurisdiction to jurisdiction.

In at least one jurisdiction, a mere showing that the utility has failed to meet its authorized rate of return is sufficient to support a request for interim relief.[43] In contrast, the Washington commission, after a review of commission decisions throughout the country, concluded, "An interim rate increase is an extraordinary remedy and should be granted only where an actual emergency exists or where necessary to prevent hardship or gross inequity" and "only where refusal to do so would cause clear jeopardy to the utility and detriment to its ratepayers and stockholders."[44] It went on to state that a mere failure by the utility to earn the previously allowed rate of return is not sufficient to warrant interim relief.[45]

Any attempt to thoroughly discuss the distinctions between the various standards employed by the several jurisdictions would only lead one inextricably into a semantic morass. For instance, the Michigan commission, although stating that the grant of interim relief does not require a showing of either emergency or extraordinary conditions, has held that a failure to earn a previously allowed return will not justify interim relief unless it is accompanied by at least one other hardship condition, such as, inability to ar-

40. *See* Mountain States Tel. & Tel. Co. v. New Mexico State Corp. Comm'n, 90 N.M. 325, 563 P.2d 588 (1977); Kauai Elec. Div. of Citizens Util. Co., 31 P.U.R.4th 1 (Hawaii P.U.C. 1979).

41. Mountain States Tel. & Tel. Co., 2 P.U.R.4th 332 (N.M. C.C. 1973).

42. Mountain States Tel. & Tel. Co., 90 N.M. at 331, 563 P.2d at 594.

43. Florida Power Corp., 8 P.U.R.4th 95th (Fla. P.S.C. 1975).

44. Washington Util. & Transp. Comm'n v. Pacific Northwestern Bell Tel. Co., 11 P.U.R.4th 166, 168 (Wash. U. & T.C. 1975).

45. *Id.* at 170-71.

range debt financing, distinctive and sudden decline in revenues, or evidence that a failure to grant interim relief will result in irreparable harm to the utility.[46]

A reading of the reported cases tends to corroborate the finding of the Washington commission that a great number of commissions require a showing of something more than a utility's inability to earn its authorized rate of return before interim relief will be granted. Additional evidence is generally required to establish that the existing revenue deficiency threatens the utility's ability to meet its public service obligation by reason of an inability to pay its current operating expenses or to obtain capital funds to construct necessary new and replacement plants.[47] At least one jurisdiction requires a showing of such a threatened impairment of the utility's ability to render service, and will then only grant temporary relief at the minimum level necessary to avert the emergency.[48]

A. Due Process in Fixing Interim Rates

Implicit in the requirement that a utility establish a need for interim relief is the requirement for some kind of hearing in which the evidence of such a need may be tested. The question of what constitutes due process, or whether due process requires a hearing before interim relief may be granted, however, is not answered consistently by the various jurisdictions. For instance, Michigan has a statutory requirement that a hearing be held prior to the granting of interim relief.[49] The Wisconsin Supreme Court has held that a statute requiring a hearing before fixing utility rates in general also mandates a hearing to determine interim rates.[50] On the other hand, the Idaho Public Utilities Commission found no statutory right to a hearing before a proposed rate increase could become effective. It held that, "As long as interim rates are placed into effect subject to refund, they do not violate due process stan-

46. Detroit Edison Co., 7 P.U.R.4th 113, 118 (Mich. P.S.C. 1974).

47. *See, e.g.*, Potomac Elec. Power Co., 9 P.U.R.4th 363 (D.C. P.S.C. 1975); Kansas-Nebraska Natural Gas Co. v. State Corp. Comm'n, 217 Kan. 604, 538 P.2d 702 (1975).

48. Dayton Power & Light Co., 41 P.U.R.4th 136 (Ohio P.U.C. 1980). The Massachusetts Department of Public Service has recently held that interim relief will only be granted for recovery of costs actually incurred or which are otherwise known and measurable. New England Tel. & Tel. Co., 41 P.U.R.4th 121 (Mass. Dep't P.S. 1980).

49. MICH. COMP. LAWS ANN. 460.62(1) (1982).

50. Wisconsin Tel. Co. v. Public Serv. Comm'n, 232 Wis. 274, 293, 287 N.W. 122, 137 (1939).

dards."[51] The commission went on to state that most courts that have considered the issue have rejected the argument that due process requires the complete litigation of every issue before interim relief can be granted. Such a holding, however, is nothing more than a necessary recognition of the definitional distinction between interim rates and permanent rates. Holding that interim rates can be authorized only after full litigation of all the issues would effectively define interim rates out of existence and render the entire issue moot.

Even those jurisdictions that require hearings prior to granting interim relief recognize that such hearings may be more abbreviated than hearings for fixing permanent rates.[52] As stated by the Michigan Court of Appeals in rejecting the argument that the state commission was without authority to render temporary relief to prevent the impairment of a utility's ability to serve the public without having before it an expert-supported analysis of the utility's financial status, "It would be foolhardy navigation to see whitecaps breaking over a reef which lies on a given course, and require that course to be maintained without an in-depth study and report on the advisability of changing it."[53]

Because of the constitutional moorings of the prohibition against confiscatory rates, including confiscatory temporary rates, the right to procedural due process to test the reasonableness of temporary rates should not be dependent on statutory provisions. The West Virginia Supreme Court of Appeals recognized this principle in a case in which it was confronted with two inconsistent statutes, one requiring a hearing before a change in utility rates could be implemented and another being silent on the issue. Rejecting the argument that the silent statute should be interpreted as allowing a rate change without a prior hearing, the court stated that administrative law originated within "constitutional perimeters" and no statute could nullify the constitutionally mandated procedural requirement of due process, either by contrary provisions or by silence.[54] Notwithstanding this constitutionally mandated requirement for procedural due process, several juris-

51. Washington Water Power Co., 22 P.U.R.4th 485, 487 (Idaho P.U.C. 1977).

52. Friends of the Earth v. Public Serv. Comm'n, 78 Wis. 2d 388, 402-03, 254 N.W.2d 299, 304 (1977).

53. Attorney General v. Public Serv. Comm'n, 63 Mich. App. 69, 77, 234 N.W.2d 407, 411 (1975).

54. Virginia Elec. & Power Co. v. Public Serv. Comm'n, 248 S.E.2d 322, 326-27 (W. Va. 1978).

dictions have adopted statutory schemes of regulation that allow utilities to set and implement their own level of interim rates without commission approval after a brief period of prior notice or suspension. Minnesota is one such jurisdiction.

B. Interim Rates in Minnesota

In Minnesota, public utilities and telephone companies may place new rates into effect upon sixty days prior notice to the state's Public Utilities Commission.[55] The commission may suspend such rates for a period of time not to exceed ten months from the initial filing date.[56] The interim rates are determined by the commission ex parte without public hearing at the time of this initial notice of rate change.[57] If the commission does not make a final determination on permanent rates within ten months from the initial filing date, the interim rates are deemed approved by the commission.[58] The statutes for both utilities and telephone companies provide that no judicial review is available until the commission has rendered its final determination, even though the interim rates may be in effect up to ten months.[59]

It is difficult to reconcile the Minnesota regulatory scheme with the constitutional prohibition against confiscatory rates and the due process requirements which pervade public utility regulation. The Minnesota scheme seems particularly ironic in view of the fact that these principles were, in large part, developed in cases arising in Minnesota. As seen, one of the original *Granger* cases upholding the public utility concept arose in Minnesota,[60] as did the cases wherein it was first held that due process required an opportunity for judicial review of ratemaking orders,[61] including those for temporary rates.[62]

While all of these cases arose out of allegations by regulated industries that existing rates resulted in confiscation of their property for public use, equal protection would seem to require that utility

55. MINN. STAT. §§ 216B.16(1), 237.075(1) (1982). Chapter 216B governs public utilities and chapter 237 governs telephone companies.

56. *Id.* §§ 216B.16(2), 237.075(2) (1982).

57. MINN. STAT. §§ 216B.16(1), 237.075(1) (1982) require the notice of rate change to "state the change proposed to be made in the rates then in force, and the time when the modified rates will go into effect."

58. *Id.* §§ 216B.16(2), 237.075(2) (1982).

59. *Id.* §§ 216B.16(3), 237.075(3) (1982).

60. *See* Winona & St. P.R.R. v. Blake, 94 U.S. 180 (1876).

61. *See* Chicago, M. & St. P. Ry. v. Minnesota, 134 U.S. 418 (1890).

62. *See* Northwestern Bell Tel. Co. v. Hilton, 274 F. 384 (D. Minn. 1921).

consumers also be entitled to due process in determining the reasonableness of temporary rates. In *Smyth v. Ames*,[63] stockholders of several railroad companies challenged the constitutionality of a Nebraska statute fixing maximum rates to be charged by rail carriers, alleging that the rates were confiscatory. In its discussion of the public duties of railroads, the Court stated that they were created as agencies of the state for a public purpose and that they perform a function of the state. Accordingly, they cannot set rates solely in their own interest and ignore the rights of the public.[64] It quoted approvingly from an earlier case, stating, "When the question arises whether the legislature has exceeded its constitutional power in prescribing rates to be charged by a corporation controlling a public highway, stockholders are not the only persons whose rights or interests are to be considered. The rights of the public are not to be ignored."[65]

Notwithstanding the United States Supreme Court's holdings in these cases, several courts have upheld regulatory statutes authorizing interim rates in essentially the same manner as Minnesota's statutes on the ground that due process does not attach to the fixing of such rates. In *Senior Citizens Clubs of Winston-Salem v. Duke Power Co.*,[66] plaintiffs brought an action under a federal civil rights statute,[67] alleging that a North Carolina statute allowing a utility to place interim rates into effect under bond after a brief suspension period deprived them of their constitutionally protected right to due process by denying them a hearing on the reasonableness of such rates. The court rejected the argument on the ground that the implementation of interim rates by the utility did not constitute the requisite state action necessary for relief under the civil rights statute.[68] The court relied on *Jackson v. Metropolitan Edison Co.*,[69] wherein the United States Supreme Court held that the termination of utility service did not constitute sufficient state action to require a prior procedural due process hearing. *Jackson*, however, based its holding on the fact that the utility had terminated service pursuant to a tariff provision filed with the Pennsylvania

63. 169 U.S. 466 (1898).

64. *Id.* at 544.

65. *Id.* at 545, *quoting* Covington & Lexington Turnpike Road Co. v. Sandford, 164 U.S. 578 (1896).

66. 425 F. Supp. 411 (W.D.N.C. 1976).

67. 42 U.S.C. § 1983 (Supp. IV 1980).

68. 425 F. Supp. at 413.

69. 419 U.S. 345 (1974).

Public Utilities Commission, but never considered by the commission in any formal proceeding. Accordingly, the commission had never placed its primatur upon the termination procedure. Such reasoning does not readily transfer to interim rate provisions contained in a comprehensive statutory scheme of regulation enacted by a state's legislature and signed into law.[70]

A decision more in accord with the holding of *Smyth v. Ames*, that the actions of a public regulated enterprise constitute state action, is *Ihrke v. Northern States Power Co.*[71] In *Ihrke*, a consumer challenged the constitutional validity of the utility's regulations governing termination of service in the City of St. Paul when that city still regulated the utility's operations within its boundaries. The action was brought under the same federal civil rights statute as was *Senior Citizens Clubs*. The district court held that the utility would not be acting under color of law in terminating service and dismissed the action. The appellate court reversed, finding that the utility's action of termination would be under color of law because the city had granted the utility an exclusive franchise and had reserved the power to extensively regulate the utility's operations within the city.[72]

In *Sellers v. Iowa Power & Light Co.*,[73] an Iowa statute allowing interim rates in a manner similar to that in Minnesota was upheld against a charge that it deprived consumers of their right to a due process hearing. The court, however, did not base its holding on the issue of state action. It stated that utility consumers have no constitutionally protected property rights in existing rates and are therefore not entitled to a procedural due process hearing prior to the implementation of interim rates.[74] Again, this decision does not readily square with the holding in *Smyth v. Ames* that rates cannot be fixed solely in the interests of the regulated industry. The United States Supreme Court has consistently held that regulatory bodies have an obligation to balance the interests of the regulated utility and its consumers.[75] Accordingly, lower court holdings that

70. *See* Memphis Light, Gas & Water Div. v. Craft, 436 U.S. 1 (1978) (municipal utility required to provide due process hearing before terminating service).

71. 459 F.2d 565 (8th Cir. 1972).

72. *Id.* at 570; *see also* Bronson v. Consolidated Edison Co., 350 F. Supp. 443 (S.D.N.Y. 1972); Palmer v. Columbia Gas Co., 342 F. Supp. 241 (N.D. Ohio 1972).

73. 372 F. Supp. 1169 (S.D. Iowa 1974).

74. *Id.* at 1174-75.

75. *See* Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944); Permian Basin Area Rate Cases, 390 U.S. 747 (1968).

consumers have no protected interest in any particular level of rates are perplexing.

At least one federal court has found that the imposition of a late penalty charge by a utility constituted action under color of law and that consumers have a right to judicial review to determine whether such a penalty constituted a confiscatory rate.[76] The court held, however, that it was prohibited by federal statute[77] from making a determination of whether or not the particular charge constituted a confiscatory rate.[78]

Another federal court held that a consumer's right to electric service is a constitutionally protected right under the doctrine of "entitlement."[79] The "entitlement" concept, as developed by the United States Supreme Court, holds that rights provided to persons by statute, even though not originally constitutionally protected rights, become such important interests that they cannot be taken away without due process merely by labeling the interest a "privilege" rather than a "right."[80] In Minnesota, where a comprehensive system of regulation has been adopted to provide retail consumers of natural gas and electric service with reliable service at reasonable rates,[81] and which provides that "[a]ny doubt as to reasonableness should be resolved in favor of the consumer,"[82] a strong argument can certainly be made that the right to utility service at a reasonable rate is an "entitlement" of utility consumers that cannot be taken away, even temporarily, through the implementation of new rates without a due process hearing.

In both *Sellers* and *Senior Citizens Clubs*, the courts were bolstered in their decisions by the fact that utility customers were protected by a provision for refund of any portion of the interim rates found to be unreasonable. Such a provision is also contained in the Minnesota scheme of regulation.[83] This is a valuable protection to consumers. The benefits of such a provision, however, are greatly diluted by the evolving phenomenon of the annual rate case. This is particularly critical in Minnesota where there are no restrictions

76. Tennyson v. Gas Serv. Co., 367 F. Supp. 102 (D. Kan. 1973).

77. *See* 28 U.S.C. § 1342 (1976).

78. 367 F. Supp. at 106.

79. *See* Bronson v. Consolidated Edison Co., 350 F. Supp. 443, 448-49 (S.D.N.Y. 1972).

80. Bell v. Burson, 402 U.S. 535, 539 (1971).

81. *See* MINN. STAT. § 216B.01 (1982).

82. *Id.* § 216B.03.

83. *See id.* §§ 216B.16(3), 237.075(3).

on when a utility or telephone company may file a new rate case and thereupon implement interim rates after the prescribed notice period.[84] Under these conditions, it is possible for a utility to file a new rate application in lieu of filing new permanent rates pursuant to a commission order in the immediately preceding rate case and thereby collect unilaterally imposed interim rates for a period of ten out of every twelve months. While such a filing of new interim rates, in lieu of an approved schedule of permanent rates, has not yet occurred in Minnesota, it has occurred and been upheld in North Dakota, a state wherein the Public Service Commission has authority to suspend interim rates for a period of eleven months.[85] Under such conditions, refund provisions offer only limited protection to consumers from excessive rates.[86]

In Minnesota, the burdens of regulatory lag have been largely shifted to consumers through the allowance of interim rates immune from either administrative or judicial review for reasonableness and which have the potential of becoming less temporary than authorized permanent rates. A strong argument can be made that through greater utilization of cost adjustment clauses the Minnesota Public Utilities Commission can relieve the consumers of much of this burden without shifting it back to the utilities or telephone companies.[87]

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84. Following are the filing dates of notices of change in rates by two of Minnesota's major electric utilities, Minnesota Power and Light Company (MP&L) and Northern States Power Company (NSP), taken from a publication of the Minnesota Department of Public Service entitled, *Utility Filings For Rate Increases, 1975-1980*, with a 1981 update.

MP&L	NSP
Feb. 18, 1976	Jan. 2, 1975
April 5, 1977	May 3, 1976
April 10, 1978	May 20, 1977
Feb. 1, 1980	May 1, 1980
May 1, 1981	July 1, 1981

85. *See* O'Connor v. Northern States Power Co., 308 N.W.2d 365 (N.D. 1981). In *O'Connor*, the commission approved a permanent rate schedule for the utility on April 26, 1977. The utility filed new interim rates in lieu thereof on May 12, 1977. Pursuant to the statutory notice period, the interim rates became effective on June 11, 1977. The commission refused to exercise its statutory authority to suspend the interim rates. *Id.* at 367.

86. The Ohio commission, which has discretion in granting interim relief, recently stated that such relief will not be granted as a substitute for, or in circumvention of, permanent rate relief. Dayton Power & Light Co., 41 P.U.R.4th 136, 140 (Ohio P.U.C. 1980).

87. It is not necessary to assume that interim rates are presently an excessive burden upon Minnesota ratepayers in order to seek remedies against the potentiality of their becoming so. As the leading spokesman for public utility regulation in the state of Maine stated in 1913:

'Here is a public utility', they say, 'we are running all right, we are not doing

VI. COST ADJUSTMENT CLAUSES

The cost adjustment clause has enjoyed only reluctant acceptance by regulatory bodies. Its general application has been largely restricted to the recovery of fuel costs, and then only from the large power users, not the residential and small commercial classes of utility customers. Historically, such clauses have received their greatest acceptance during periods of inflation, particularly inflation spurred by war time demands for large quantities of fuel.[88] Two of the earliest fuel adjustment clauses were adopted in the war year of 1917 by the Illinois and New Hampshire commissions. The Illinois commission justified the clause on the basis of a then recent sixteen percent increase in the cost of coal.[89] The New Hampshire commission relied upon the then present abnormally high cost of coal.[90]

Not all commissions, however, were willing to break new regulatory ground by adopting adjustment clauses for the purpose of accommodating the unprecedented war economy fuel prices.[91] In *Rockford Electric Co.*,[92] the same Illinois commission, which less than one month previously had approved one of the earliest fuel adjustment clauses, rejected a similar proposal for reasons that to this day remain the primary arguments against such clauses.

The first reason given by the Illinois commission for rejecting the clause was that state law required all utilities to file schedules of rates for services to be furnished.[93] The adjustment clause violated this law, the commission held, because by its terms it was impossible to determine rates until after the service had been fur-

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> anything wrong, nor we won't do anything wrong, it ought not to be regulated, not touched upon'. . . . But we believe the commission, should have authority, if necessary, to do it. Why, you have been out in the woods without a gun. . . . You were not likely to meet any wild thing. The chances were against that, that you wouldn't meet any. But when you want a gun you want it awfully bad. It may not be necessary in the case of many corporations, to do much with them in this State. They are doing good business, hones and square. But you want power. You want authority.

New England Tel. & Tel. Co. v. Public Util. Comm'n, 354 A.2d 753, 759 n.4 (Me. 1976).

88. For a history of fuel adjustment clauses, see Foy, *Cost Adjustment in Utility Rate Schedules*, 13 VAND. L. REV. 663 (1960); Trigg, *Escalator Clauses in Public Utility Rate Schedules*, 106 U. PA. L. REV. 964 (1958); Note, *Due Process Restraints on the Use of Automatic Adjustment Clauses in Utility Rate Schedules*, 18 ARIZ. L. REV. 454 (1976).

89. Alton Gas & Elec. Co., 1917F P.U.R. ANN. 12, 21 (Ill. P.U.C. 1917).

90. Rockingham County Light & Power Co., 1917F P.U.R. ANN. 24, 25 (N.H. P.S.C. 1917).

91. *See* Alton Gas & Elec. Co., 1917F P.U.R. ANN. 12, 23 annot. (Ill. P.U.C. 1917).

92. 1917F P.U.R. ANN. 196 (Ill. P.U.C. 1917).

93. *Id.* at 198-99.

nished and the cost of fuel used in providing that service had been calculated.[94] The objection to fluctuating rates resulting from adjustment clauses has been broadened to include the argument that such fluctuations would be annoying and confusing to customers, particularly to residential and small commercial customers.[95]

A second reason given in *Rockford Electric* for rejection of the adjustment clause was that the commission had the statutory obligation to fix reasonable rates and that the operation of the adjustment clause would constitute an improper delegation of that authority to the utility.[96] The commission acknowledged that it could still investigate the reasonableness of the rate so established, but concluded that in such an investigation the burden of proof as to the appropriate level of rates would be improperly shifted from the utility to the commission.[97]

Yet another reason given by the Illinois commission for rejecting the fuel adjustment clause was the belief that it gave undue weight to one single item of cost and failed to give adequate attention to all other operating costs in determining the utility's return.[98] The underlying concept is that while the costs of fuel may be increasing, these costs might be offset by decreases in other operating costs. The net effect would be a constant return on equity to the utility without a need for additional revenue increases.[99] The commission also feared that allowance of the fuel adjustment clause would be used as the foundation for expanded adjustment clauses that would automatically pass through to consumers these other costs.[100]

Finally, the Illinois commission touched upon the issue of procedural due process. Due process has developed into one of the major issues facing modern commissions and courts in dealing with adjustment clauses. While the Illinois commission did not expressly mention notice and the requirement for hearing, it did point out that Illinois law provided that no rate increase should be

94. *Id.* at 199.

95. Georgia Power & Light Co., 74 P.U.R.(N.S.) 69, 78 (Ga. P.S.C. 1948); Public Serv. Gas Co., 1920E P.U.R. ANN. 396, 397 (N.J. Bd. P.U. 1920).

96. 1917F P.U.R. ANN. at 200.

97. *Id.*; *see also* Jones v. Montpelier & Barre Light & Power Co., 1921D P.U.R. ANN. 145 (Vt. P.S.C. 1921); Fox v. Pine Grove Elec. Light, Heat & Power Co., 1920B P.U.R. ANN. 380, 385 (Pa. P.S.C. 1911) (adjustment clause held incompatible with spirit of regulatory statute).

98. 1917F P.U.R. ANN. at 200.

99. *See* Northwest Natural Gas Co., 9 P.U.R.4th 361 (Or. P.U.C. 1975).

100. 1917F P.U.R. ANN. at 199.

granted except upon a showing to the commission that such an increase is justified. The commission interpreted this to mean a "formal showing" and found that the clause violated this statutory requirement because it did not provide for any such "real showing."[101]

While the objections to the adjustment clause raised by the Illinois commission in 1917 still confront modern day utility commissions and courts,[102] it has been stated that a majority of the cases reported between 1917 and 1931 approved fuel adjustment clauses,[103] and that in 1960, rate schedules in at least forty states and the District of Columbia contained fuel adjustment clauses.[104]

A. Due Process Requirements for Adjustment Clauses

As in the case of interim rates, the question of what constitutes adequate procedural due process in the implementation of cost adjustment clauses varies from jurisdiction to jurisdiction. In most reported cases on the issue, due process requirements are measured by local statutory requirements for notice and opportunity for hearing in utility rate cases.

The New Jersey Supreme Court has upheld a comprehensive adjustment clause, providing for the recovery of salary, wage, depreciation, and other expenses, on the basis of a statute allowing the commission to negotiate and agree with any utility for an adjustment of rates during the pendency of a rate proceeding. The commission order had provided that the amounts collected under the clause would be subject to scrutiny for reasonableness during the pending rate proceeding and that any amount found to be excessive would be refunded through customer credits. Since the state statutes governing rate proceedings provided for both notice to consumers and an opportunity for them to be heard, the court held that the public's right to due process was adequately protected.[105] In short, the New Jersey court treated the comprehensive adjustment clause in largely the same manner as the Minnesota statutory scheme treats interim rates, with the notable

101. *Id.* at 201.

102. For a recent case rejecting a fuel adjustment clause for virtually identical reasons as *Rockford Electric*, see State *ex rel.* Utility Consumers Council of Missouri, Inc. v. Public Serv. Comm'n, 585 S.W.2d 41 (Mo. 1979).

103. Note, *supra* note 88, at 455.

104. Foy, *supra* note 88, at 669.

105. *See In re* Board's Investigation of Tel. Cos., 66 N.J. 476, 333 A.2d 4 (1975) (with strong dissent in opposition to clause).

exception that the New Jersey commission retains jurisdiction to fix the terms of the adjustment clause and, therefore, the amount of interim relief utilities may collect.

Other jurisdictions tend to treat adjustment clause rate increases as permanent rate increases. The provisions of such clauses are measured against the due process requirements of the statutes governing general rate proceedings, and not against statutes governing interim rates. The Vermont Supreme Court has struck down fuel and purchased power adjustment clauses on the ground that their failure to provide notice to consumers before every increase occasioned by their operation violated the statutory requirement for thirty days prior notice for every new rate filing.[106] The Wisconsin Supreme Court has similarly held that a comprehensive adjustment clause, similar to the one upheld by the New Jersey court, was invalid because the rate increases resulting from its operation would violate a statute requiring hearings to be held before any change in schedules that constitute an increase in rates may go into effect.[107]

Several jurisdictions have used a less literal definition of "rate change" in upholding adjustment clauses in the face of statutes requiring prior notice before any new rate increases may be implemented. In one of the earliest cases in which an adjustment clause came under judicial review,[108] the Supreme Court of Appeals of Virginia upheld a purchased gas adjustment clause whereby the utility passed on to its retail customers the increased costs of its purchased gas without prior notice to the retail customers, even though a state statute provided that no change shall be made in any rate schedule without due notice to the public. The court stated that rate schedules are not mere lists of rates in dollars and cents. They also contain provisions for determining rates in the future and the adjustment clause is merely a fixed rule in the form of a mathematical formula for making such a determination. Accordingly, "The resulting rates under the escalator clause are as firmly fixed as if they were stated in terms of money."[109] The Supreme Judicial Court of Massachusetts has likewise held that, so long as the formula contained in the adjustment clause remains

106. *See In re* Allied Power & Light Co., 132 Vt. 354, 321 A.2d 7 (1974).

107. Wisconsin's Envtl. Decade, Inc. v. Public Serv. Comm'n, 81 Wis. 2d 344, 260 N.W.2d 712 (1978).

108. City of Norfolk v. Virginia Elec. & Power Co., 97 Va. 505, 90 S.E.2d 140 (1955).

109. *Id.* at 516, 90 S.E.2d at 148; *see also* City of Chicago v. Illinois Commerce Comm'n, 13 Ill. 2d 607, 150 N.E.2d 776 (1958).

fixed, no hearings are required for mathematical fluctuation in rates pursuant to the clause. Due process was afforded to utility customers under a general statutory provision requiring the state's Department of Public Service to give notice and conduct a hearing on the quality or price of gas or electric service, either on its own motion or upon the filing of a complaint by any twenty customers of a given utility. The fact that this required some initiative on the part of consumers did not suggest unfairness.[110]

B. Adjustment Clauses in Minnesota

The Minnesota Public Utilities Act allows the Public Utilities Commission to permit public utilities to file rate schedules containing adjustment clauses.[111] The Public Utilities Commission rules also provide for an electric energy adjustment clause[112] and a purchase gas adjustment clause.[113] The electric energy clause allows utilities to pass on to customers costs of purchased power[114] and the costs of fossil and nuclear fuel consumed in the generation of electricity.[115] The electric energy adjustment is the average cost of energy purchased and fuel consumed per kilowatt hour during the current period, defined as the most recent two month moving average[116] less the base costs per kilowatt hour.[117] The adjustment must be calculated monthly and applied to the billing period succeeding the calculation.[118] The purchase gas adjustment clause requires three separate calculations; a commodity adjustment,[119] a demand adjustment,[120] and a manufactured gas adjustment.[121] All of the adjustments made under these clauses must be implemented and stated on the customer's bill.[122]

The adjustments that result from these clauses may be placed into effect without prior commission action, subject to two condi-

110. Consumers Org. For Fair Energy Equality, Inc. v. Department of Pub. Util., 368 Mass. 599, 335 N.E.2d 341 (1975).
111. MINN. STAT. § 216B.16(7) (1982).
112. 13 MINN. CODE AGENCY R. PSC 392 (1982).
113. *Id.* PSC 393.
114. *Id.* PSC 390(F).
115. *Id.* PSC 390(G).
116. *Id.* PSC 390(L).
117. *Id.* PSC 392(B).
118. *Id.* PSC 392(C).
119. *Id.* PSC 393(B)(1).
120. *Id.* PSC 393(B)(2).
121. *Id.* PSC 393(B)(3).
122. *Id.* PSC 392(A), PSC 393(A).

tions.[123] The first condition is that any error in an adjustment in excess of five percent of the corrected adjustment must be refunded to the customer with interest.[124] A second and more significant condition from the viewpoint of due process allows the commission, either upon complaint or upon its own motion, to conduct an investigation pursuant to notice and hearing and, as a result of such investigation, fix at current levels, discontinue, or modify any automatic adjustment provision for an individual utility.[125] Any proposed revision in the electric energy or purchase gas adjustment clauses is deemed a change in rates and will be reviewed according to commission rules and practices relating to rate changes.[126]

Minnesota adjustment clauses provide essentially the same due process protections found adequate by the Massachusetts court,[127] and certainly greater protections than the Minnesota Public Utilities Act provides in the allowance of interim rates. The question remains whether or not these same protections could be built into an expanded and more comprehensive adjustment clause allowing utilities and telephone companies to recover other legitimate operating costs relatively contemporaneously with the incurrence thereof so as to reduce the need for frequent and extended rate case hearings.

C. Fuel Adjustment Clauses Versus Comprehensive Adjustment Clauses

Cost adjustment clauses drafted to specify precisely what costs may be recovered pursuant to their provisions are strictly procedural in nature. By far the vast majority of adjustment clauses dealt with in the reported cases provide for the recovery of the types of costs which are normally allowed as utility operating costs. Very few such cases turn on the issue of whether or not the costs attempted to be recovered should be allowed to the utility as legitimate operating costs.[128] Therefore, reasoning that accepts the fuel

123. *Id.* PSC 394(C).

124. *Id.* PSC 394(D).

125. *Id.* PSC 34(E). MINN. STAT. § 216B.17 (1982) provides that the commission shall investigate the rates and regulations upon its own motion or on complaint of any political subdivision, the Department of Public Service, another utility or 50 customers of a particular utility. Accordingly, the rules applicable to the adjustment clauses provide greater protection than the statute by not fixing a minimum number of customers who may initiate an investigation through the complaint procedure.

126. 13 MINN. CODE AGENCY R. PSC 395(C) (1982).

127. *See supra* note 11 and accompanying text.

128. For cases denying adjustment clauses designed to recover utility company contri-

adjustment clause, but denies the more comprehensive clause designed to recover costs of salaries, wages, taxes, supplies, and equipment, is strained at best.

The Wisconsin Supreme Court displayed a certain discomfort in making such a distinction without a difference in denying a comprehensive adjustment clause in *Wisconsin Environmental Decade, Inc. v. Public Service Commission*.[129] In the body of its opinion, the court discussed the history of fuel adjustment clauses and pointed out that they have been used by Wisconsin utilities since 1918. It then pointed out that the validity of the fuel adjustment clause was not at issue in the case at hand. In a final footnote, the court pointed out that the comprehensive adjustment clause that it had just struck down included aspects typical of the more traditional fuel adjustment clauses. The court took pains to reiterate that the validity of those fuel adjustment clauses was not at issue in the case. It then went on to state that the comprehensive clause under consideration was invalid because of its additional elements.[130] The court never attempted to explain why the comprehensive adjustment clause requires due process hearings and the fuel adjustment clause does not.[131]

The objection raised continuously since *Rockford Electric*—that single costs should not be considered in isolation, but must be considered in the context of the utility's overall costs—is no more valid as to those costs contained in the comprehensive clauses than it is to fuel costs. In fact, in jurisdictions such as Minnesota, where the regulatory commission reserves jurisdiction to review the cost adjustments and requires a filing of the data underlying such adjustments,[132] a strong argument can be made that the more comprehensive the adjustment clause the more information the commission will have at its disposal for determining whether some

butions to the Gas Research Institute because said contributions were found not to be in the best interests of consumers, see Western Slope Gas Co., 31 P.U.R.4th 93 (Colo. P.U.C. 1979); Intermountain Gas Co., 27 P.U.R.4th 281 (Idaho P.U.C. 1978).

129. 81 Wis. 2d 344, 260 N.W.2d 712 (1978).

130. *Id.* at 352 n.4, 260 N.W.2d at 716 n.4.

131. In a subsequent rate case, Wisconsin Elec. Power Co., 41 P.U.R.4th 268 (Wis. P.S.C. 1980), the commission stated that the fuel adjustment clause has performed satisfactorily during this decade in enhancing the opportunity for the utility to recover just and reasonable operating costs, thereby minimizing overall capital costs. *Id.* at 278.

132. *See* 13 MINN. CODE AGENCY R. PSC 394 (1978). This rule requires all utilities to file annually their procurement policies for selecting sources of fuel and energy purchased, their dispatching policies, a summary of actions taken to minimize costs, and a summary of the computation of each adjustment.

cost reductions may offset other cost increases and result in no need for additional or overall revenue increases to the utility.

Another argument against the adjustment clause is that its automatic allowance of the recovery of increased costs will reduce the utility's incentive to minimize such costs. It is argued that if the utility can automatically pass these increased costs on to its customers it will not make any great efforts to engage in hard bargaining in procuring the essential labor, supplies, and equipment at costs favorable to its customers. It is recognized by proponents of this argument that some costs, such as fuel, purchased power, purchased gas, and taxes are, to varying degrees, beyond the control of the utility and are therefore more appropriately allowed to be automatically passed on to customers. Nevertheless, the argument retains its persuasiveness in many jurisdictions.

One method of ensuring a continuation of a utility's incentive to keep its operating costs at a minimum is to allow it to recover only a portion of an increase in its operating costs through the adjustment clause. In *Montana-Dakota Utilities Co.*,[133] the South Dakota commission was confronted with a classic case containing all of the elements which would seem to justify such a procedure. In that case, the utility's fuel supplier was its wholly owned coal mining subsidiary. On the basis of this relationship, the commission staff argued that the price paid for coal by the utility was not a reasonable standard and urged that the utility be allowed to recover only 75% of its increased coal costs through its fuel adjustment clause.[134] The commission accepted the argument in principle but allowed the utility to recover 90% of such costs.[135] In a proceeding in which such an affiliated interest was not present, the California commission ordered a 98% recovery of increased fuel costs in order to ensure the utilities' incentive for hard bargaining in procurement of fuel.[136] Applying a provision similar to that in Minnesota, it also required the utilities to which the energy clauses were to be applied to file all fuel procurement contracts, solicitations, bids, and offers with reasons for rejecting any bids, solicitations, and offers.[137]

The Minnesota commission does not place any restrictions on

133. 21 P.U.R.4th 1 (S.D. P.U.C. 1977).
134. *Id.* at 18.
135. *Id.*
136. Energy Cost Adjustment Clauses, 31 P.U.R.4th 81, 86 (Cal. P.U.C. 1980).
137. *Id.* at 87-88.

the percentage of actual incurred cost increases utilities may recover through electric energy and purchase gas adjustment clauses. Nevertheless, through continuing and diligent monitoring of the utilities' procurement policies, consumers should be well protected against any lack of hard bargaining by the utilities.

If the commission were to allow the recovery of additional costs through an expanded adjustment clause structured essentially the same as the present electric energy and purchase gas clauses, it might be necessary to require implementation of the adjustments on something less frequent than a monthly basis and to require implementation of all cost adjustments on fixed but staggered dates for each utility or telephone company. Since the Public Utilities Act and the telephone statute provide a sixty day lag for the recovery of cost increases, it would seem reasonable to allow the implementation of cost adjustments pursuant to a comprehensive adjustment clause at sixty day intervals. By staggering the implementation dates for the various utilities and telephone companies under its jurisdiction, the commission could structure a schedule for reviewing the periodic adjustments and would not be inundated with monthly cost adjustments.[138] By providing a sixty day lag period within which the utility or telephone company would be required to absorb any cost increases, the utility would have a continuing incentive to keep cost increases as low as possible under present inflationary conditions.

VII. CONCLUSION

The provisions for interim rates in Minnesota provide substantially less due process protection to the consumers than does the allowance for the recovery of costs by the utilities through the electric energy and purchase gas adjustment clauses, inasmuch as the Minnesota Public Utilities Commission retains jurisdiction to investigate and modify these latter adjustments. It is clear that the automatic recovery of electric energy and purchase power costs through the adjustment clause has not reduced the need for frequent rate changes by Minnesota utilities. This is obviously due to parallel increases in other costs of operations presently recoverable only through the mechanism of a general rate case. In order to prevent the loss of recovery of these cost increases during the pe-

138. The California commission provides for a triannual adjustment and has staggered the implementation dates of the four utilities subject to the energy cost adjustment clause. *Id.* at 86-87.

riod of regulatory lag attendant upon a rate case, the utilities and telephone companies must recover them through interim rates in a manner provided by law. By means of a properly constructed comprehensive adjustment clause, the frequency of new rate case filings could be reduced by allowing utilities and telephone companies to recover significant and non-controversial operating costs, yet affording consumers an opportunity to timely challenge any cost adjustment made pursuant to the provisions of such a clause.